No. 15924

In the United States Court of Appeals for the Ninth Circuit

JACK J. WALLEY, Executor of the Estate of MURREY LONDON, Deceased, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment of the United States District Court for the Southern District of California

BRIEF FOR APPELLEE

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CITATIONS

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BRIEF FOR APPELLEE

OPINION BELOW

The opinion of the District Court (R. 33-40) is not officially reported.

JURISDICTION

These appeals involve federal withholding, insurance contribution, and unemployment taxes for the years 1947 and 1948. (R. 20.) This suit for collection was initiated on March 8, 1957, under the provisions of Section 7403 of the Internal Revenue Code of 1954. (R. 6.) The jurisdiction of the District Court

was invoked under 28 U.S.C., Sections 1340 and 1345. (R. 19.) The judgment was entered on December 30, 1957. (R. 24.) The notice of appeal was filed on February 11, 1958. (R. 25.) The jurisdiction of this Court is invoked under 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether the District Court correctly held that the Bankruptcy Court's final order of allowance of the tax claim has the effect of a judgment in favor of the United States to the extent that it can be enforced without limitation as to time.

STATUTES INVOLVED

The statutes involved may be found in the Appendix, *infra.*

STATEMENT

The facts were stipulated and were so found by the District Court (R. 18-23, 34) and may be summarized as follows:

The Commissioner of Internal Revenue timely assessed withholding, insurance contribution, and unemployment taxes against Murrey London (taxpayer) from February, 1948, through July, 1948. (R. 34.)

On March 1, 1948, taxpayer filed a voluntary petition in bankruptcy in the court below. The United States filed a claim in the proceeding for $5,759.04, the amount alleged to be then owing on the taxes in question. This tax claim was allowed by the Bankruptcy Court without contest. The trustee in bankruptcy paid a dividend of $243.29 in partial satisfaction of the allowed claim. Nothing further has been

paid on account of these taxes. An order discharging taxpayer of all debts except certain non-dischargeable debts was duly entered in the bankruptcy proceedings. (R. 20-21.)

Taxpayer died on September 13, 1954, and Jack Jay Walley was appointed as his executor. In due course the United States filed a claim against taxpayer's estate for the unpaid balance of the tax claim on June 29, 1955, more than six years after the last assessment relative to the taxes in question. On July 8, 1955, a formal approval of this claim was filed by the executor. On November 7, 1955, the executor petitioned the court to vacate this approval and on November 8, 1955, the court made an order vacating its previous order allowing the claim. An amended claim was filed in the probate proceeding on January 3, 1956, which claim provided that it amended and superseded the prior claim dated June 28, 1955, and set forth as the basis the judgment resulting from the allowance of the tax claim in the bankruptcy proceedings. A formal rejection of the amended claim was filed by the executor on January 4, 1956. (R. 21-22.)

This action against the executor followed on March 8, 1957. (R. 6.) The District Court held that the allowance of the tax claim in bankruptcy constituted in effect a final judgment in favor of the United States upon which there is no statute of limitations. (R. 22-23.) The District Court entered judgment in favor of the United States for $8,949.85, together with interest. (R. 23-24.) The executor appealed from that judgment. (R. 25.)

SUMMARY OF ARGUMENT

A final order of allowance of the taxes in question was made in a bankruptcy proceeding commenced within the statutory limit. This action for the collection of the taxes is barred unless the final order of allowance of the tax claim in the bankruptcy proceedings amounted to a judgment in favor of the United States enforceable without limitation as to time.

The applicable case law holds that the allowance of a claim in bankruptcy is a judgment and, after the time for review has passed, is *res judicata* in a subsequent suit on the merits as to the bankrupt and one in privity with him.

That the allowance of a claim remains a judgment even though no contest was made in the bankruptcy proceeding is indicated by the continuing *res judicata* effect in such an event. *Res judicata* applies not only to matters which were raised, but also, assuming that objections had existed but had not been made, to matters which could have been raised. In this instance the burden was on the bankrupt taxpayer, whose interest was sufficient, to both object to an allowance if he had reason to dispute the claim and to petition for review before the allowance became final.

That an adjudication was made on the merits of the tax claim in question is seen from the fact that under Section 64a (4) of the Bankruptcy Act, only those taxes "legally due and owing by the bankrupt" can be ordered paid by the Bankruptcy Court. The exclusive jurisdiction to adjudicate the amount and

legality of such a tax devolves upon the Bankruptcy Court. Thus, all final allowances of a tax claim are determinations on the merits of that claim.

The reliance of taxpayer's executor upon the fact of no objection to the allowance in order to avoid its judgment effect is misplaced. If the bankrupt taxpayer agrees that a legally due claim is valid, an objection thereto would be unwarranted. Besides, the courts hold that the allowance of an uncontested claim is a final adjudication of the taxes if no timely review is taken.

The order of allowance made without objection on the merits of the tax claim became final after the time for review passed and is a judgment with *res judicata* effect. This judgment should be, and is, enforceable without limitation as to time just like any other judgment in favor of the United States.

ARGUMENT

The Final Order of Allowance of a Tax Claim In a Bankruptcy Proceeding Is a Judgment In Favor of the United States Which Can Be Collected Without Limitation As To Time

In the absence of the final order of allowance made by the Bankruptcy Court the collection of the taxes, subject of the claim filed in the probate estate, would have been barred by the statute of limitations. A proceeding in court to collect the taxes can only be commenced within six years after the assessment of the taxes. Section 3312(d) of the Internal Revenue Code of 1939 (Appendix, *infra*). More than six years has elapsed between the assessment of the taxes and taxpayer's death. However, as taxpayer's executor

concedes (Br. 8), the filing of the tax claim in the bankruptcy proceeding began a "proceeding in court" within the meaning of Section 3312(d). Since the final order of allowance of the tax claim in that bankruptcy proceeding amounted to a judgment in favor of the United States enforceable without limitation as to time, this action for the collection of taxes is not barred.

No question is raised concerning the rule that there is no statute of limitations on a judgment in favor of the United States if such judgment is the result of a timely proceeding in court to collect the taxes. *Investment & Securities Co.* v. *United States*, 140 F. 2d 894, 896 (C.A. 9th); *United States* v. *Ettelson*, 159 F. 2d 193, 196 (C.A. 7th); *United States* v. *Havner*, 101 F. 2d 161 (C.A. 8th). The question that is raised is whether the final order of allowance of the tax claim in the bankruptcy proceeding is equivalent to a judgment in favor of the United States so that it is enforceable without limitation as to time.

The allowance of a claim in bankruptcy has long been regarded as a judgment. *United States* v. *American Surety Co. of New York*, 56 F. 2d 734 (C.A. 2d); *In re John Osborn's Sons & Co.*, 177 Fed. 184 (C.A. 2d). In *United States* v. *American Surety Co. of New York*, 56 F. 2d 734, 736, the Second Circuit has stated as a general principle that (p. 736):

> It may also be conceded that the allowance or disallowance of a claim in bankruptcy should be given like effect *as any other judgment* of a competent court, in a subsequent suit against the bankrupt or any one in privity with him. (Emphasis added.)

This Court, in *United States* v. *Coast Wineries*, 131 F. 2d 643, 648, quoted with approval the above statement of the Second Circuit. This Court further stated that the allowance of a claim in bankruptcy should be given the *res judicata* effect of a judgment so as not to be questioned in subsequent proceedings because (p. 648):

> The judgments, decrees, and orders of the bankruptcy court in bankruptcy matters possess all the attributes of finality and estoppel accorded to judgments from courts of general original jurisdiction.

It has long been established that after the time for review has passed the action of a referee in bankruptcy allowing or disallowing a claim is a judgment with *res judicata* effect. *Sterns Salt & Lumber Co.* v. *Hammond*, 217 Fed. 559 (C.A. 6th); *Lewith* v. *Irving Trust Co.*, 67 F. 2d 855 (C.A. 2d); *Donald* v. *Bankers Life Co.*, 107 F. 2d 810 (C.A. 5th); *In re Tinkoff*, 85 F. 2d 305 (C.A. 7th), certiorari denied, 299 U.S. 611. As a result, in a subsequent suit on the merits, the allowance or disallowance of a claim in the bankruptcy proceeding is binding on the bankrupt and anyone in privity with him. *United States* v. *Coast Wineries*, 131 F. 2d 643, 648-649 (C.A. 9th); *United States* v. *American Surety Co. of New York*, 56 F. 2d 734, 736 (C.A. 2d); *In re Henry Holzapfel's Sons, Inc.*, 249 F. 2d 861 (C.A. 7th); 5 Remington, Bankruptcy 482 (5th ed., 1953).[1]

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[1] Taxpayer's executor relies on *In re McChesney*, 58 F. 2d 340 (S.D. Cal.), and *Massee & Felton Lumber Co.* v. *Benen-*

Taxpayer's executor attempts to avoid the judgment effect of a final allowance in bankruptcy upon the tenuous ground that taxpayer made no contest in the bankruptcy proceedings.[2] But, as held by the District Court below (R. 37), inasmuch as the bankrupt taxpayer failed to object to the claim in proceedings to which he was a party and in which he could have contested it, neither he, nor by privity his executor, would be permitted to question the merits in a subsequent suit. That is, assuming *arguendo*, that there might have been some basis for objection to the tax claim, the bar of *res judicata* would continue to be available to the Government for *res judicata* may be raised not only as concerns matters actually presented to sustain a right asserted in a prior proceeding but also as to any other available matter which might have been presented. *Fishgold* v. *Sullivan Corp.*, 328 U.S. 275, 282-283; *Chicot County Dist.* v. *Bank*, 308 U.S. 371, 378; *Cromwell* v. *County of Sac.*, 94 U.S. 351, 352.

The taxpayer was under an affirmative duty in the bankruptcy proceedings to "examine and report to his trustee concerning the correctness of all proofs of claim filed against his estate * * *" (Section 7a (3) of the Bankruptcy Act (Appendix, *infra*)), which duty would, of course, extend to the tax claim here

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son, 23 F. 2d 107 (S.D. N.Y.), in Point I of his brief. These two District Court cases are properly deemed overruled *sub silentio* to the extent inconsistent with the court's holding and the Government's position. (R. 40.)

[2] It should be noted that no question has ever been raised as to the actual merits of the tax claim against the taxpayer. The only defense raised herein is the statute of limitations.

allowed. Taxpayer's interest in the nondischargeable tax claim (Section 17a(1) of the Bankruptcy Act (Appendix, *infra*) was sufficient to give him standing to object to its allowance if he had had reason to dispute, and, if he had deemed the order of allowance erroneous, to petition for review. (Sections 57d and k of the Bankruptcy Act (Appendix, *infra*); General Order 21(6), (11 U.S.C. 1952 ed., following Sec. 53); *In re Povill*, 105 F. 2d 157, 159 (C.A. 2d); *In re Woodmar Realty Co.*, 241 F. 2d 768 (C.A. 7th); 3 Collier, Bankruptcy, 218-220 (14th ed., 1940)).

Furthermore, the reliance of taxpayer's executor upon the fact of no objection to the allowance in order to avoid its effect as a judgment ignores the basic proposition that a bankruptcy court is permitted to order, and the bankruptcy estate to pay, only those taxes which are "legally due and owing by the bankrupt * * *". Section 64a(4) of the Bankruptcy Act (Appendix, *infra*); *In re Florence Commercial Co.*, 19 F. 2d 468, 470 (C.A. 9th), certiorari denied, *sub nom.*, *Truman* v. *Thalheimer*, 275 U.S. 542. The allowance of the tax claim, herein, and the payment of a portion thereof, show that there necessarily was an adjudication of the merits.[3] Section 64a(4) fur-

[3] The examination of the proof of claim at the least as to its conformity with the Bankruptcy Act is a "judicial act." *In re Branner*, 9 F. 2d 883, 886 (C.A. 2d). The "allowance" under Section 57d of the Bankruptcy Act does not even require a formal order if no objections were made, and such an "allowance" was considered as reduced to judgment. *New York, N. H. & H. R. Co.* v. *Reconstruction Fin. Corp.* 180 F. 2d 241, 246 (C.A. 2d).

ther provides that "in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court * * *". The net effect is that the Bankruptcy Court has exclusive jurisdiction to, and does, adjudicate the amount or legality of any tax assessed against the bankrupt. *In re Florence Commercial Co., supra; Cohen* v. *United States,* 115 F. 2d 505 (C.A. 1st); *Hamel* v. *United States,* 135 F. Supp. 482 (N.H.); *In re Maryland Coal Co. of West Virginia,* 36 F. Supp. 142 (N.D. W. Va.). Therefore, that all final allowances of a tax claim are determinations on the *merits* of the tax claim should go without saying.

Apparently taxpayer's executor grants that a final order of allowance or disallowance is a judgment final in the absence of review if objections have been filed. (Br. 16.) Yet the executor assumes that a final allowance without objection is not on the merits and claims that it therefore does not rise to the dignity of a judgment. (Br. 14.) The absurdity of this position is self-evident for he is saying that if a valid tax claim is found legally due and owing by a Bankruptcy Court and is conceded valid by a bankrupt taxpayer, the order of allowance can only become a judgment if an unwarranted objection is filed.

Additionally, the executor's comment that not one of the cases cited in the opinion or by the Government ever held that an order of a referee has the effect of a judgment without objections having been made (Br. 17), is refuted by *Cohen* v. *United States,* 115 F. 2d 505 (C.A. 1st). Therein, a tax claim was filed in a bankruptcy proceeding. That claim was duly allowed, no charge was ever made of fraud or mistake

as to its entry, and no review was sought. No objections were made and no hearings were held. The Government contended that where proof of claim for taxes had been allowed by the referee in bankruptcy and no petition for review was filed, the adjudication of the amount and legality of the taxes became final and the trustee's subsequent suit for refund could not be allowed. The First Circuit agreed stating (p. 507): "This was a final adjudication of the tax claim * * *." Also, in an analogous decision, *United States* v. *Ettelson*, 159 F. 2d 193, 196 (C.A. 7th), an uncontested tax claim was filed in probate. The Seventh Circuit held that the claim was a proceeding in court sufficient to stop the running of the statute of limitations and the judgment could be enforced at any time.

When there is no question as to the merits of the claim, as in the instant case, an allowance on the merits is made by the Bankruptcy Court without the need of controversy. When the time for reconsideration has passed,[4] the order of allowance of the tax claim has all the substantial elements of a judgment as to finality and estoppel. There is no reason why such a final order of allowance cannot be enforced without limitation as to time like any other final judgment in favor of the United States.

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[4] It is to be noted that Section 57(k) of the Bankruptcy Act (Appendix, *infra*) specifically provides that an allowed claim may be reconsidered "*before but not after* the estate has been closed." (Emphasis added.) It is also to be noted that Section 57(k) has been misquoted by the executor (Br. 14), wherein the above quotation has been entirely eliminated.

Lewith v. *Irving Trust Co.*, 67 F. 2d 855 (C.A. 2d), cited by the executor (Br. 15), is not in point. The question there was whether *before the estate had been closed* a claim could be heard for the second time. The Court held it could not be reconsidered.

CONCLUSION

The judgment of the District Court is correct and should be affirmed.

Respectfully submitted,

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May, 1958.

APPENDIX

Internal Revenue Code of 1939:

SEC. 3312. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except in the case of income, estate, and gift taxes—

* * * *

(d) *Collection After Assessment.*—Where the assessment of any tax imposed by this title has been made within the statutory period of limitation properly applicable thereto, such tax may be collected by distraint or by a proceeding in court, but only if begun—

(1) Within six years after the assessment of the tax, or

(2) Prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer.

(26 U.S.C. 1952 ed., Sec. 3312.)

Bankruptcy Act, c. 541, 30 Stat. 544:

SEC. 7. [as amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840]. *Duties of bankrupts.* a. The bankrupt shall * * * (3) examine and report to his trustee concerning the correctness of all proofs of claim filed against his estate; * * *

(11 U.S.C. 1952 ed., Sec. 25.)

SEC. 17. [as amended by Sec. 1, Act of June 22, 1938, *supra*] *Debts not affected by a discharge.* a. A discharge in bankruptcy shall release a bankrupt from all of his probable debts, whether allowable in full or in part, except such

as (1) are due as a tax levied by the United States, * * *

(11 U.S.C. 1952 ed., Sec. 35.)

SEC. 57. [as amended by Sec. 1, Act of June 22, 1938, *supra*] *Proof and allowance of claims.*

* * * *

d Claims which have been duly proved shall be allowed upon receipt by or upon presentation to the court, unless objection to their allowance shall be made by parties in interest or unless their consideration be continued for cause by the court upon its own motion: * * *

* * * *

k Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part according to the equities of the case, before but not after the estate has been closed.

* * * *

l Whenever a claim shall have been reconsidered and rejected, in whole or in part, upon which a dividend has been paid, the trustee may recover from the creditor the amount of the dividend received upon the claim if rejected in whole, or the proportional part thereof if rejected only in part, and the trustee may also recover any excess dividend paid to any creditor. The court shall have summary jurisdiction of a proceeding by the trustee to recover any such dividends.

* * * *

(11 U.S.C. 1952 ed., Sec. 93.)

SEC. 64. [as amended by Sec. 1, Act of June 22, 1938, *supra*]. *Debts which have priority.* a.

The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: * * * *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; * * *.

* * * *

(11 U.S.C. 1952 ed., Sec. 104.)

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